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DIRECTORATE OF
INTELLIGENCE

Intelligence Memorandum

Communist China: Continued Upswing In Trade With Japan

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CENTRAL INTELLIGENCE AGENCY
Directorate of Intelligence
July 1971

INTELLIGENCE MEMORANDUM

COMMUNIST CHINA: CONTINUED
UPSWING IN TRADE WITH JAPANSummary and Conclusions

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1. Japan, China's number one trading partner since 1965, provides such important imports as chemical fertilizer, industrial machinery, construction and transportation equipment, and specialty steel products. A large portion of China's imports of high-technology goods come from Japan, [redacted] China's military research and production, as well as its general economic development, reap substantial benefits from this trade. The political element is present in all Sino-Japanese trade negotiations, but it has clearly been subordinate to economic considerations during the past decade.

2. In 1970, total trade between the two countries jumped by \$200 million to \$855 million, about 20% of China's total foreign trade but only 2% of Japan's foreign trade. Most of the 1970 expansion came in Chinese imports - which rose from \$415 million in 1969 to \$600 million in 1970. As a result, the already sizable trade deficit rose to a record \$345 million.

3. China's trade with Japan in 1971 appears likely to expand by "only" 10%, the rise in exports being roughly in line with the rise in imports. The rate of growth beyond 1971 probably will slow down further, unless the Chinese lose their reluctance to incur long-term foreign indebtedness. Chinese requirements for Japanese technology and industrial products will increase as the Fourth Five-Year Plan (1971-75) progresses. Because of Peking's policies of technological and financial self-reliance, China will continue to maintain a high degree of selectivity in imports.

Note: This memorandum was prepared by the Office of Economic Research and coordinated within the Directorate of Intelligence.

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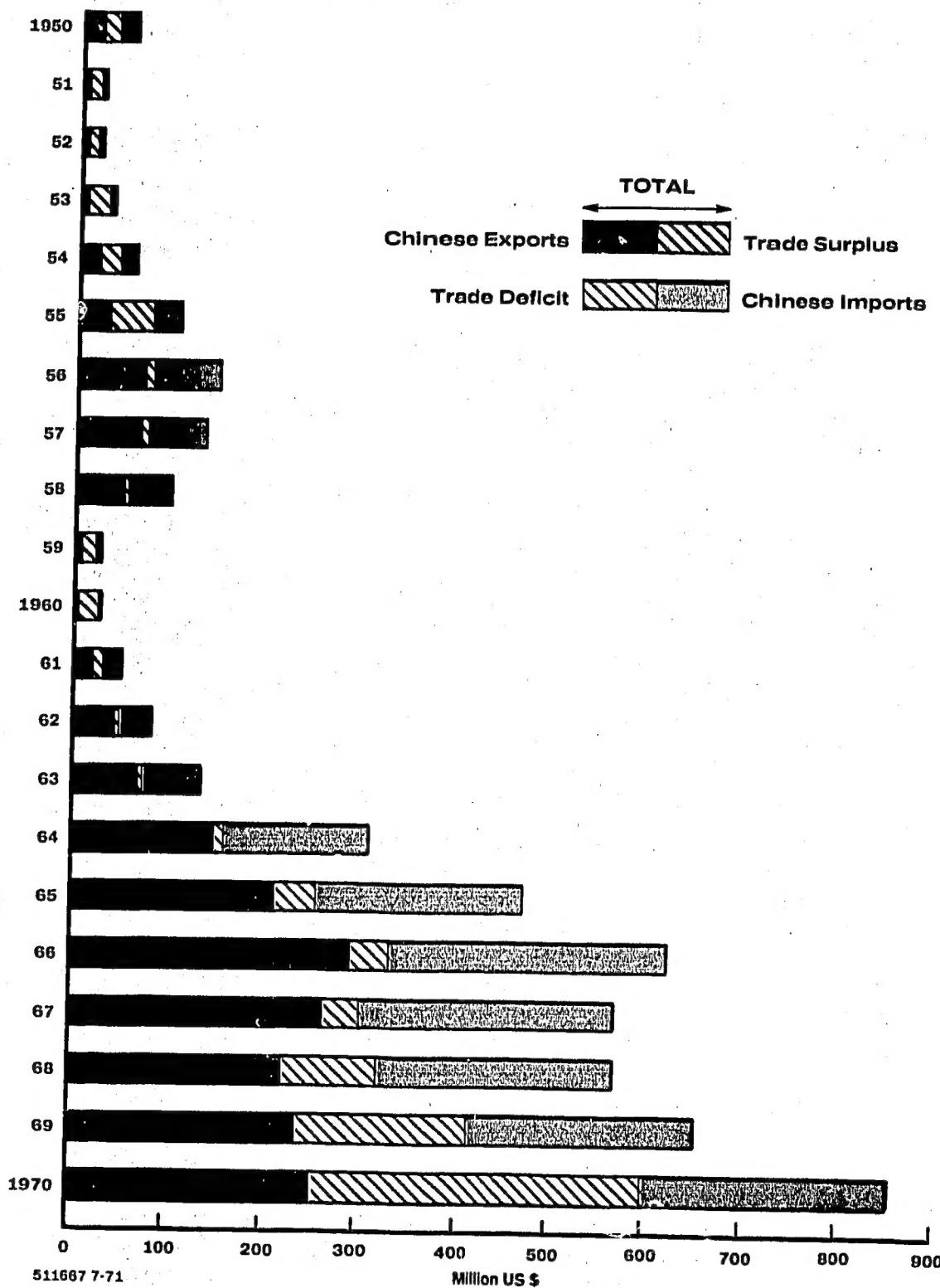
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4. In the absence of long-term credits, the expansion of imports will be tied closely to export possibilities. Chinese exports in the first quarter of 1971 rose by 23% while imports registered a small decline. Raw silk and foodstuffs have sparked this spurt in exports, and steady though small expansion in these exports in the next few years appears possible. Greater gains could come if the Chinese resume exports of coking coal and make petroleum available to Japan. The need of Japanese industry for those two commodities is almost insatiable. In the case of coking coal, however, Chinese domestic demand is rising rapidly and little is likely to be available for export. In the case of petroleum, the outlook is more promising, and the Chinese might have as much as 10 million tons of petroleum available for export by 1975.

Discussion**Background**

5. The level of Sino-Japanese trade during the past two decades has been influenced by both economic and political considerations. In the early 1950s, China's entry into the Korean War caused trade to fall sharply. After the war, trade recovered and by the end of China's First Five-Year Plan (1953-57) was nearly two and one-half times the 1950 volume (see the chart). By late 1957, however, China was becoming more sensitive to the approaching renewal of the security pact between Japan and the United States. China seized upon the Nagasaki flag incident (the tearing down of the Chinese flag by two young Japanese toughs at the Nagasaki Trade Fair in May 1958) as an excuse to institute a drastic cut in Sino-Japanese trade. Imports from Japan were slashed from \$52 million in 1958 to \$4 million in 1959 and \$3 million in 1960. During this period, visiting Japanese were assured that an advantageous trade pattern could be negotiated if Japan would abandon its hostile attitude toward China.

6. The Sino-Soviet rift and the collapse of the Leap Forward (1958-60) made it impossible to maintain the distorted trade pattern. Therefore, Communist China dropped the three principles (no hostility toward Communist China, no two-China conspiracy, and no opposition to normalization of relations) that it had announced in 1958 as governing trade. In their stead, China substituted new principles calling for governmental trade agreements, agreements between individual firms, and continuing trade of certain goods. China's more pragmatic approach ushered in a period of rapid growth in Sino-Japanese trade which began in 1961 and, with the exception of 1967-68, has continued to the present.

SECRET**COMMUNIST CHINA: Trade with Japan****SECRET**

~~SECRET~~Japan Moves Up

7. Sino-Japanese trade began to assume major significance for China in 1964 when turnover more than doubled to \$310 million and Japan's share of China's total trade jumped to 10%. A primary impetus for increased Sino-Japanese trade came from the rapid fall-off in Sino-Soviet and Sino-East European trade which followed the widening of the Sino-Soviet rift in 1960. China's imports from the USSR, which were \$955 million in 1959 had fallen to only \$135 million by 1964. Japan, because of its geographical and cultural propinquity as well as its capacity to supply needed industrial products at highly competitive prices, was a natural alternative source of supply.

8. Japan replaced the Soviet Union as China's leading trading partner in 1965 (a position it has held even since); trade that year increased 52% to \$470 million. Sharp increases in imports of machinery and equipment and fertilizers led to a \$44 million deficit, the first sizable deficit in trade with Japan.

9. China's growing demands for chemical fertilizer and an upsurge in purchases of iron and steel forced imports still higher in 1966. A 37% increase in China's exports offset the higher imports and the trade deficit remained at the 1965 level. Exports of foodstuffs (\$119 million) and oilseeds (\$58 million) reached record levels in 1966. In subsequent years, sales of both foodstuffs and oilseeds have been depressed, making it difficult for China to avoid large deficits in its trade with Japan.

A Temporary Decline

10. Sino-Japanese trade fell 9% in 1967, the first decline in this trade since 1959. Smaller purchases of fertilizer, iron and steel, and machinery and equipment were paralleled by reduced sales of foodstuffs and oilseeds. The lower level of trade in 1967 was directly attributable to the economic disruptions of the Cultural Revolution - factory shutdowns, shortages of coal and electric power, delays in transportation, and purges of economic bureaucrats. The foreign trade sector as a whole suffered from these disruptions, and total trade fell by approximately the same percentage as Sino-Japanese trade.

11. The economic dislocations of the Cultural Revolution continued on into 1968. The lessened availability of crude materials, coupled with Japan's growing self-sufficiency in the production of rice, resulted in a further sharp decline in China's exports to Japan. At the same time, China's imports of Japanese fertilizer and steel increased \$42 million, pushing total imports from Japan up from \$303 million to \$345 million. The trade deficit with Japan was \$123 million in 1968, more than triple the 1967 level.

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New Heights

12. The economic effects of the Cultural Revolution had largely faded away by the start of 1969, and Sino-Japanese trade resumed its amazing growth. The surge in imports in 1969 was led by sharp gains in purchases of steel, machinery and equipment, nonferrous metals, and fertilizer. Imports of \$415 million exceeded the \$239 million of exports by \$176 million, and it became clear that China was willing to incur a continuing large deficit in its trade with Japan.

13. Economic planning and administration had settled back to normal in 1970, the last year of the third Five-Year Plan, which had been engulfed by the Cultural Revolution. Both agricultural and industrial production reached new highs, and Sino-Japanese trade shared in the general advance. Trade turnover grew by 31% over 1969 to \$855 million. Of the \$201 million increase, \$185 million was in Chinese imports and only \$16 million in Chinese exports. Thus, Chinese exports remained below previous peak levels attained in 1966-67, but imports were nearly twice as great as during that earlier period. The deficit in 1970 was a record \$345 million.

14. Of the \$185 million increase in imports in 1970 over 1969, two categories accounted for \$150 million — machinery and equipment and iron and steel. The sharpest rise in imports in 1970 was in machinery and equipment — from \$47 million in 1969 to \$120 million in 1970. This category, which was 11% of total imports in 1969, accounted for 20% in 1970. Particularly noteworthy were the quadrupling of imports of transportation equipment, a more than tripling of imports of metalworking machinery, and a recovery in imports of construction and mining machinery to levels approaching those of 1965. Trade in other categories of machinery generally continued along trends established in the last five years. The largest absolute increase in imports in 1970 over 1969 was in iron and steel products, which increased from \$172 million in 1969 to \$249 million in 1970. Japan probably supplied more than 70% of China's imports of iron and steel products in 1970.

15. Chinese exports to Japan in 1970 continued well below the peak level of 1966. Exports of animal and vegetable products and textiles continued to rise slightly, while export of oilseeds again declined and grain exports remained near the depressed level of 1969.

Western Europe a Loser

16. Part of the reason for the rapid growth of China's imports from Japan in 1968-70 can be attributed to a reorientation of trade from Western Europe to Japan. Western Europe's exports to China, which totaled \$720 million in 1967, had fallen to \$565 million in 1969 and recovered partially

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to about \$660 million in 1970. Because of shorter shipping times, lower freight costs, and competitive pricing, Japan has an advantage over Western Europe in the supply of many items, particularly bulk commodities like steel and fertilizer. The closing of the Suez Canal and the ease with which the Japanese have been able to provide those products most desirable to the Chinese have added to the Japanese advantage in the last few years.

Memorandum Trade

17. The sharp increase in Sino-Japanese trade in the 1960s was facilitated by the institution of the "Japan-China Memorandum Trade Agreement" and the ease with which politically imposed conditions for trade were circumvented. COCOM restrictions, the Yoshida letter, and such minor skirmishes as the disagreement over acceptance of Chinese meat products by the Japanese exerted some restraining influence on this trade. Nonetheless, except in Memorandum Trade, politics have clearly been subordinated to economic needs in most instances. China recognizes the limitations of its influence in Japan and has rarely been willing to abandon its import priorities in favor of political objectives.

18. In the absence of formal diplomatic relations between the two countries, the nearest thing to an official trade channel is the "Japan-China Memorandum Trade Agreement." Memorandum Trade was started in 1963. (It is based on an agreement between Liao Cheng-chih and Tatsunosuke Takasaki and thus was originally called L-T Trade.) This trade is renegotiated annually between Chinese officials and influential members of Japan's ruling Liberal Democratic Party. Each year, the Japanese delegates ritualistically denounce the fundamentals of Japan's foreign policy and then proceed to arrange the next year's contracts, which are parceled out among loyal government supporters. The trade normally includes Japanese exports of chemicals, steel, and machinery and Chinese exports of minerals and agricultural products.

19. Memorandum Trade accounted for more than 50% of Sino-Japanese trade in 1963 and in absolute value reached a peak of nearly \$200 million in 1966. Since then, the amount and proportion have declined steadily so that this trade now accounts for only about \$70 million, or less than 10% of total Sino-Japanese trade. Memorandum Trade as a portion of total trade in 1963-71, is as follows:

<u>Year</u>	<u>Percent</u>	<u>Year</u>	<u>Percent</u>
1953	51	1968	20
1964	40	1969	11
1965	36	1970	8
1966	31	1971	7-1/2 a/
1967	27		

a. *Projected.*

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Friendly Firms

20. Most trade with Japan is now carried out between the government of China and "friendly firms." Any Japanese firm can become a "friendly firm" and thereby carry on trade with China as long as it meets the various conditions imposed by the Chinese from time to time. Conditions supposedly imposed at present are encompassed in the following "Four Principles" which were announced by Premier Chou En-lai in April 1970.

- (1) China will not trade with those who want to help South Korea and Taiwan;
- (2) China will not trade with those investing in enterprises in Taiwan and South Korea;
- (3) China will not trade with those sending arms to wars staged by the United States in Vietnam, Laos, and Cambodia;
- (4) China does not intend to trade with American enterprises in Japan.

According to Chou's statement, China will cancel contracts with Japanese trading firms, whether they are engaging in memorandum trade or friendly trade, if they go against these principles.

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Commodity Composition of Trade

24. In recent years about three-fourths of China's imports from Japan have consisted of iron and steel, fertilizer, and machinery and equipment (see Table 1). Imports of iron and steel increased by four times between 1965 and 1970, from \$49 million to \$249 million. Not only have these imports grown sharply in absolute terms, but they have also increased relative to other imports. In 1970, iron and steel accounted for 42% of China's purchases from Japan in contrast to 19% in 1965. China's imports of steel include basic shapes and plates, strips, wire, tubes and pipes, and a variety of special steels.

25. Japan is also a major source of chemical fertilizer for China. Imports increased rapidly until 1966 when fertilizer purchases totaled more than \$90 million. Larger sales by the West European consortium Nitrex depressed Japanese sales below the 1966 level in 1967-69. In 1970, Japanese sales reached \$97 million, slightly above the 1966 level. The benefits of lower shipping rates from Japan are illustrated in the instance of fertilizer imports. In 1969, purchases on an f.o.b. basis from Japan and Western Europe were \$81 million and \$80 million, respectively; delivered costs were \$88 million from Japan, compared with \$111 million from Western Europe. Thus, in the purchase of roughly equivalent amounts of fertilizer, China had to pay an additional \$24 million to cover the freight differential from Western Europe. Major types of fertilizer imported from Japan are urea, ammonium sulphate, and ammonium chloride.

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Table 1
Communist China: Commodity
Composition of Sino-Japanese Trade a/

	Million US \$					
	1965	1966	1967	1968	1969	1970
Chinese imports	267	331	303	346	415	600
Crude materials, fuels and edible oils	16	12	15	8	9	15
Of which:						
Textile fibers	15	11	12	4	4	7
Chemicals	97	121	104	120	132	147
Of which:						
Fertilizers	75	92	74	81	88	97
Manufactures	143	197	184	217	273	437
Of which:						
Textile yarn and fabric	13	16	14	15	14	15
Iron and steel	49	112	108	143	172	249
Nonferrous metals	1	2	7	12	24	28
Machinery and equipment	65	49	41	31	47	120
Other	1	1	b/	b/	1	1
Chinese exports	213	291	266	222	239	255
Crude materials, fuels, and edible oils*	92	123	131	109	123	123
Of which:						
Oilseeds	50	58	55	51	48	42
Textile fibers	9	19	25	23	32	36
Crude animal materials	5	6	6	6	6	6
Foodstuffs	77	119	89	71	55	67
Of which:						
Animals, meat, fish	18	32	21	19	22	33
Grains	41	59	39	23	2	23
Fruits and vegetables	15	21	20	19	20	26
Chemicals	5	7	9	10	18	23
Manufactures	39	41	36	30	41	42
Of which:						
Textile yarn and fabrics	1	4	9	11	16	16
Clothing	1	2	3	6	10	10
Iron and steel	23	21	9	1	b/	b/
Nonferrous metals	1	4	2	2	1	1
Other	b/	1	1	2	2	b/

a. Data are based on official Japanese statistics and have been
adjusted to show China's imports c.i.f. and China's exports
f.o.b.

b. Less than \$500,000.

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26. In the 1950s, when the USSR supplied the machinery and technicians for China's industrialization, imports were predominantly basic materials and equipment. In the 1960s, in contrast, the Chinese themselves are able to handle most of the basic industrialization requirements and depend on imports for higher technology items. Japan and Western Europe have supplanted the USSR as industrial supplier. 1/ China's imports of machinery and equipment from Japan nearly doubled from \$65 million to \$120 million between 1965 and 1970. After jumping sharply in 1965, imports gradually declined in 1966-68 to a low of \$31 million. Imports increased by about 50% in 1969 to \$47 million and nearly tripled in 1970 to \$120 million. The rapid rises in 1969-70 reflects the recovery of plant expansion activity in China following the Cultural Revolution and the resumption of systematic forward planning.

27. Table 2 gives a more detailed breakdown of machinery and equipment imports by China in 1965-70. Sharp declines occurred from 1965 to 1968 in imports of construction and mining machinery, textile machinery, heating and cooling equipment and electrical machinery. On the other hand, imports of internal combustion engines, metalworking machinery, pumps and centrifuges, bearings, and transport equipment remained stable or increased during this period and then rose sharply in 1969-70. These changes indicate the greater need for more complex equipment and China's attempts to expand its transport capabilities. The imports in 1965 and 1970 also reflect Chinese plans for large-scale construction as a new five-year plan period approached.

28. Although nonferrous metals comprise only a small portion of total imports from Japan, the growth of such imports has been phenomenal — from \$1 million in 1965 to \$28 million in 1970. The growth has been part of a substantial Chinese effort to obtain nonferrous metals throughout the world. Nonferrous metals imported from Japan include copper — nearly 90% of the total in 1970 — aluminum, platinum, zinc, and titanium.

29. Chinese exports to Japan in 1970 were somewhat above the level in 1965, although below that of 1966. Exports of grain, mostly rice, declined sharply from \$41 million in 1965 to \$3 million in 1970. This decline was more than made up for by increases in exports of textile fibers and products, which increased from \$11 million in 1965 to \$62 million in 1970. Oilseeds have ranged between \$40 million and \$60 million annually, as shown in Table 1.

Importance of Japanese Trade to China

30. Trade with Japan was about 20% of total Chinese foreign trade in 1970. The proportion has markedly increased over the past decade, as shown in the following tabulation.

1/ For a comparison of the commodity composition of Sino-Soviet trade in 1958 and Sino-Japanese trade in 1970, see the Appendix.

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<u>Year</u>	<u>Sino-Japanese Trade (Million US \$)</u>	<u>Total Chinese Trade (Million US \$)</u>	<u>Sino-Japanese Trade as a Percent of Total Chinese Trade</u>
1958	102	3,735	2.7
1959	22	4,265	0.5
1960	23	3,975	0.6
1961	46	3,015	1.5
1962	84	2,675	3.1
1963	137	2,770	4.9
1964	310	3,220	9.6
1965	470	3,850	12.2
1966	622	4,205	14.8
1967	569	3,860	14.7
1968	567	3,710	15.3
1969	654	3,855	17.0
1970	855	4,250	20.1

31. But, more important, Japan is China's leading supplier of modern plants and technology and advanced industrial products (such as alloy steels). Japan can supply many industrial goods and materials more cheaply than its chief competitor, Western Europe, because of lower production and shipping costs.

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Although most of the items that China receives from Japan could be purchased elsewhere, the lower costs and the ease of getting the most advanced technology have worked to China's advantage. Thus, a loss of the Japanese supply would be a stiff economic and technical blow to the Chinese.

Relation to Military Effort

32. Machinery and industrial materials imported from Japan have contributed significantly to the development of China's modern weapons, including the expansion of its industrial support base. Quantification of the contribution is not possible, and links between specific imports and programs for military research and development and for production are imprecise. Nevertheless, complete plants from Japan, such as vacuum furnaces and plants to manufacture vinylon, micrometers, oil-hydraulic pressure equipment, high-purity silicon, semiconductors, and magnetic recording tape have filled important technological gaps in China's military-industrial base. Moreover, some portion of import items that could have either general industrial or military application are probably used in

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Table 2

Communist China: Imports of Machinery
and Equipment from Japan ^{a/}

Name of Commodity	1965	1966	1967	1968	1969	1970	Million US \$
<i>Total machinery and equipment</i>	<u>61.9</u>	<u>46.9</u>	<u>38.8</u>	<u>29.3</u>	<u>44.4</u>	<u>114.3</u>	
Machinery other than electric	<u>45.6</u>	<u>31.7</u>	<u>25.0</u>	<u>19.1</u>	<u>30.3</u>	<u>69.8</u>	
Of which:							
Internal combustion engines, other than aircraft	0.6	2.1	0.4	0.7	3.0	2.7	
Track-laying type of tractors	11.4	1.1	0.1	0	1.2	2.3	
Metal working machinery	2.6	6.1	5.7	4.2	5.2	17.2	
Of which:							
Machine tools for working metal	2.6	5.2	2.6	3.6	4.6	16.6	
Textile machines	6.2	2.5	0.9	0.1	0.3	Negl.	
Construction and mining machinery, n.e.s.	10.1	2.0	0.3	0.1	0.8	7.8	
Machinery and appliances (other than electrical, and machine parts, n.e.s.)	13.4	15.9	16.7	12.7	19.1	39.0	
Of which:							
Heating and cooling equipment	3.5	2.2	5.1	0.8	0.5	0.7	
Pumps and centrifuges	4.2	4.9	4.8	3.4	6.7	14.1	
Mechanical handling equipment	0.7	1.4	1.4	1.6	0.4	3.6	
Powered tools, n.e.s.	0.3	0.9	0.5	1.1	1.9	4.5	
Ball, roller, or needle roller bearings	0.4	0.2	2.2	4.0	6.7	13.1	
Machinery and mechanical appliances, n.e.s.	2.7	4.1	1.7	0.4	0.5	0.6	
Parts and accessories of machinery, n.e.s.	0.9	0.9	0.7	1.2	2.4	2.2	
Electrical machinery, apparatus, and appliances	<u>13.2</u>	<u>12.7</u>	<u>11.4</u>	<u>6.5</u>	<u>5.1</u>	<u>5.6</u>	
Of which:							
Electrical measuring and controlling instruments and apparatus	5.2	5.7	3.2	1.6	1.9	1.6	
Transport equipment	<u>3.1</u>	<u>2.5</u>	<u>1.6</u>	<u>3.7</u>	<u>9.0</u>	<u>38.9</u>	
Of which:							
Railroad vehicles	0.4	1.6	0.1	1.9	4.7	8.2	
Road motor vehicles	1.7	0.5	0.7	1.8	4.2	29.3	

a. Data given are f.o.b. Japan and thus differ from those in Table 1, which are given o.i.f. China.

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military programs. Among the items that fall into this category are metalworking machinery, pumps and centrifuges, bearings, telecommunications equipment, professional and scientific instruments, special purpose construction and transportation equipment, nonferrous metals, and chemicals other than fertilizers.

Importance of Chinese Trade to Japan

33. Chinese trade is only a very small share of the total trade of Japan - slightly over 2% in 1970. Communist China is tied with the USSR as the 11th leading trading partner of Japan, far below the United States, Australia, and Canada and even below Asian countries such as Taiwan, South Korea, and Indonesia. Thus, from the viewpoint of total trade, China is relatively insignificant to Japan. The percent that Chinese trade has been of total Japanese trade is shown in the following tabulation:

<u>Year</u>	<u>Sino-Japanese Trade (Million US \$)</u>	<u>Total Japanese Trade (Million US \$)</u>	<u>Sino-Japanese Trade as a Percent of Total Japanese Trade</u>
1965	470	16,600	2.8
1966	622	19,300	3.2
1967	569	22,100	2.6
1968	567	26,000	2.2
1969	654	31,000	2.1
1970	855	38,200	2.2

34. Looking at particular commodities, Chinese trade is most important to the Japanese chemical fertilizer industry - China accounted for 73% of Japanese exports of urea, 83% of exports of ammonium chloride, and 70% of exports of ammonium sulfate in 1970. Because of the worldwide overcapacity in chemical fertilizer, the Japanese could not readily replace these sales in other markets. No other categories of exports account for more than 20% of Japanese exports. In regard to imports, Chinese commodities do not appear to be particularly significant to Japan; although silk products and some food products provide a substantial part of Japan's import needs. Nevertheless, the Japanese consider China to be an important potential export market as well as a possible source for industrial raw materials.

Comparisons with Japanese-Taiwan Trade

35. In recent years, Japan's trade with Taiwan has grown even more rapidly than trade with Communist China as shown in the following

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tabulation (data are in million US dollars, and Japanese trade with Communist China is shown in parenthesis):

<u>Year</u>	<u>Japanese Exports</u>	<u>Japanese Imports</u>	<u>Total Trade</u>	<u>Japanese Trade Surplus</u>
1965	218 (257)	157 (213)	375 (470)	61 (44)
1966	255 (331)	147 (291)	402 (622)	108 (40)
1967	328 (303)	137 (266)	465 (569)	191 (37)
1968	472 (345)	151 (222)	623 (567)	321 (123)
1969	606 (415)	180 (239)	786 (654)	426 (176)
1970	700 (600)	251 (255)	951 (855)	449 (345)

Japan is Taiwan's leading trading partner and accounted for nearly 30% of total Taiwanese trade in 1970. Japanese imports from Taiwan are similar to those from China, consisting largely of foodstuffs and crude materials, although foodstuffs comprise a much larger portion of imports from Taiwan. About twice the volume of manufactures is imported from Taiwan as from China; in addition to textiles, these include large amounts of plywood and electronic equipment.

36. The commodities Japan exports to the two countries also are similar, consisting largely of manufactures, especially machinery and iron and steel products. The products exported to Taiwan, however, reflect the greater consumer orientation of that economy - for example, textile machinery, automotive equipment, electrical equipment, civilian telecommunications equipment, synthetic yarns and fibers, and plastic materials. In contrast, exports to Communist China feature products useful to heavy industrial and military programs.

37. Both Communist China and Taiwan face the same problem in their trade with Japan - how to increase exports. If anything, prospects are even poorer for Taiwan because it does not have large amounts of raw materials for Japanese industry. Foodstuffs exports should increase gradually, however, so exports probably will continue to rise. Japan will continue to be Taiwan's key source of machinery, iron and steel products, synthetic fibers, and plastics, and, because of favorable balances in its trade with the less developed countries, Taiwan should be able to sustain a large deficit in future trade with Japan.

Prospects for 1971

38. Although expansion of Sino-Japanese trade in 1971 will be substantial, it will fall well below the 30% increase of 1970. The Chinese

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Communists appear unwilling to permit any large increase in their trade deficit with Japan, and they are currently unable to provide large quantities of those items that Japan wants most — coking coal, iron ore, oilseeds, and petroleum. Sino-Japanese trade in 1971 probably will fall between \$900 million and \$950 million. Japanese contracts concluded at the spring Canton Fair totaled \$176 million, well above the \$130 million at the 1970 spring fair and the \$150 million at the 1970 fall fair. Another general indicator is the state of the Chinese economy, which made further substantial percentage advances in the first half of 1971 — certainly in industry and construction.

39. Despite a small decline in imports in the first three months, contracts that have been concluded or are being negotiated indicate that Chinese imports from Japan will increase on the order of \$50 million in 1971, bringing total imports to about \$650 million. Imports of iron and steel products are expected to increase by about 10%, and the Japanese are hoping for a similar increase in Chinese fertilizer purchases. For the first time, China is purchasing pig iron from Japan; contracts for 1971 delivery of more than \$10 million worth have been concluded thus far. The Japanese have received a sizable order for electric shovels — about \$42 million worth — at least part of which will be delivered in 1971. Chinese truck purchases may also be up, and ball bearing imports are expected to more than double. On the other hand, machine tool orders have been disappointing; Japanese firms hope to receive more orders later in the year. Nonferrous metals imports probably will be up in 1971.

40. A 23% increase in Chinese exports in the first three months of 1971, increased sales at the spring Canton Fair, and a small increase in exports scheduled under the Memorandum Trade Agreement indicate that Chinese exports may also increase substantially in 1971. Soybean exports in the Memorandum Agreement are scheduled to be the same in 1970, and contracts completed indicate that total soybean exports will remain at about \$36 million. For the first time in several years, corn is being exported to Japan — a contract for export of 50,000 tons has been signed and further contracts are in the offing. Also, Japanese purchases of animal and vegetable products, raw silk, silk fabrics, and clothing should continue to rise in 1971. Some increase may occur in Japanese purchases of nonferrous metals — particularly tin and antimony. It is unlikely, however, that total exports will increase by more than 10%. They will probably remain below \$300 million in 1971. Thus the trade deficit almost certainly will be at least as large as that of 1970.

Longer Term Prospects

41. Longer term prospects depend on a number of factors. Chinese requirements for imports from Japan will increase as the Fourth Five-Year

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Plan (1971-75) unfolds. The needs of the Chinese should turn more and more to industrial machinery and equipment, including complete plants; thus imports of machinery and equipment are likely to rise considerably. The present emphasis on imports of transportation equipment and construction equipment will probably continue for a year or two. As the initial phases of new construction projects are completed, these requirements may taper off toward the latter part of the plan period. Although, fertilizers, iron and steel, and nonferrous metals will be needed in increasing quantities, domestic production may fill an increasing proportion of total requirements. China's reluctance to depend heavily on foreign sources of materials and equipment dampen the prospects somewhat, and the Chinese will probably remain selective in their foreign purchases. In general, China as a nation of continental dimensions can supply most of its needs internally. Imports are less than 2% of estimated gross national product (GNP), and since 1957 the volume of foreign trade has been growing less rapidly than GNP.

42. Provided the political atmosphere remains fairly favorable, a main factor in the level of Sino-Japanese trade will be Chinese willingness and ability to increase exports to Japan. If the Chinese decide to resume exports of coking coal, which the Japanese are anxious to buy, and if the Chinese provide petroleum and additional foodstuffs and oilseeds, total trade turnover could be increased considerably. For example, the Japanese have reported the possibility of China's selling 10 million tons of coking coal annually to Japan, and China might have as much as 10 million tons of petroleum available for export by 1975. These two commodities alone could expand export earnings by \$250 million to \$300 million in 1975. However, rapidly rising internal demand for coking coal will probably keep the increase well below this level.

43. The Japanese are exerting considerable effort to maintain their favorable position in Chinese trade. For example, the Japanese are sending numerous delegations to China to discuss trade prospects and have shown a willingness to exhibit Chinese goods in Japan. A special section of the Japanese trade ministry has been set up just to handle trade with China and Southeast Asia. The Japanese also are talking of removing preferential tariffs - particularly those on raw silk and silk fabrics, that adversely affect trade with China - and have offered to buy additional industrial raw materials from the Chinese.

44. Prospective revision of law governing the Japanese Export-Import Bank would facilitate the use of bank loans to finance exports to China. This could have some effect on sales of machinery and equipment to China. The Chinese, however, have hesitated to buy on credit in the recent past and there is no evidence that their policy has changed in this regard. Moreover, the Japanese are unlikely to jeopardize their trade relations with

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other Asian countries unless they have some guarantees of extensive increases in Chinese trade with Japan. Such guarantees are unlikely to be forthcoming from the present Chinese government.

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SECRET**APPENDIX****Communist China: Commodity Composition of Sino-Soviet Trade in 1958 and Sino-Japanese Trade in 1970**

<u>Commodity Category</u>	<u>Sino-Soviet Trade, 1958</u>	<u>Million US \$</u>	<u>Sino-Japanese Trade, 1970</u>
<i>Chinese exports</i>	881		255
Crude materials, fuels, and edible oils	224		123
Of which:			
Textile raw materials	38		36
Nonferrous and alloy metals, ores, and concentrates	74		3
Foodstuffs	219		67
Textiles	194		26
Other	244		39
<i>Chinese imports</i>	634		600
Machinery and equipment	318		120
Of which:			
Complete plants	166		<u>N.A. a/</u>
Petroleum and petroleum products	92		0
Chemicals	<u>N.A. b/</u>		147
Iron and steel	61		249
Nonferrous metals	16		28
Miscellaneous	33		56
Other	114 <u>c/</u>		0

a. Data not available but shipments of items for complete plants probably were very small.

b. A small amount of chemical imports are included under "miscellaneous".

c. Representing the value of goods not listed by Soviet sources and believed to be primarily of military and strategic origin.

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